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Executive Director
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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

October 6, 1998

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
1919 M Street, NW, Room 222, SC-1170
Washington, DC 20554

RE: CC Docket No. 98-157: Petition of U S WEST Communications, Inc. for Forbearance from Regulation as a Dominant Carrier in the Phoenix, Arizona MSA

Dear Ms. Salas:

On October 5, 1998, Jeff Brueggeman, Tom Colgan, and the undersigned, representing U S WEST Communications, Inc., met with Jane Jackson and Tamara Preiss of the Competitive Pricing Division to discuss the above-referenced proceeding. A copy of the materials discussed in the meeting is attached.

In accordance with Section 1.1206(a)(2) of the Commission's rules, an original and one copy of this letter and the attachments are being filed with your office for inclusion in the record of this proceeding.

Acknowledgment and date of receipt of this submission are requested. A duplicate letter is attached for this purpose.

Please call if you have any questions.

Sincerely,

B B Nugent

Attachments

cc: Ms. Jane Jackson
Ms. Tamara Preiss

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List A B C D E

U S WEST PETITION FOR FORBEARANCE FROM DOMINANT CARRIER REGULATION IN THE PHOENIX, ARIZONA MSA
Executive Summary
August 5, 1998

U S WEST's petition requests that the FCC exercise its authority under Section 10 of the Telecommunications Act of 1996 to forbear from regulating U S WEST as a dominant carrier in the provision of high capacity services (i.e., special access and dedicated transport for switched access at DS1 and higher transmission levels) in the Phoenix, Arizona MSA. The petition is narrowly tailored in terms of the services and geographic area covered, and the relief requested.

1. U S WEST Lacks The Ability To Exercise Market Power In The Phoenix Area Market For High Capacity Services

Following the approach the FCC previously has used to assess market power in the AT&T non-dominant proceeding and other proceedings, the renowned economists Alfred E. Kahn and Timothy J. Tardiff conclude that U S WEST lacks market power in the Phoenix area market for high capacity services.

First, as detailed in the Quality Strategies market analysis, U S WEST faces intense competition from both resellers and five established facilities-based competitors with substantial resources and extensive fiber networks. These established companies – which include the recently combined AT&T/TCG and MCI/MFS WorldCom companies – have access to resources equal to or greater than U S WEST's.

Second, U S WEST has a steadily declining market share. Indeed, competitive providers have captured more than 70 percent of the retail market for high capacity services. This is the most important market share statistic because the retail provider of high capacity services is the party that has the direct relationship with the customer. In fact, the customer may not even be aware of the identity of the carrier actually provisioning the underlying high capacity facilities. Therefore, the retail provider has a significant marketing advantage over the facilities provider and, in the case of U S WEST's competitors, the ability to offer a full service package to the customer that includes interLATA voice and data services.

Further, expansion of the competitive providers' business has been even more rapid than the impressive 13 percent growth in the demand for high capacity services in the Phoenix market. During the period from the fourth quarter of 1994 to the fourth quarter of 1997, the competitive providers' market share of the "provider" segment (i.e., high capacity services ultimately purchased by end users) increased from less than six percent to 28 percent. The competitive providers' market share of the "transport" segment (i.e., high capacity services purchased by carriers for transport) also is growing rapidly, increasing from five percent to 16 percent between the second quarter and the fourth quarter of 1997 alone. Perhaps the most significant trend statistic is the fact that, between the second and fourth quarter of 1997, competitive providers captured 54 percent of the growth in demand of the provider segment and 42 percent of the growth in demand of the transport segment. Share of growth is the primary indicator of what a competitor's installed-base market share will look like in the future – and competitive providers in the Phoenix area have captured a majority share of market growth over the past several years.

Third, there is high demand elasticity. The customers that tend to purchase high capacity facilities – medium to large businesses, governmental entities and other carriers – are highly sensitive to price and other service characteristics. The ability of U S WEST's largest carrier customers to migrate high capacity traffic to their own affiliated fiber networks further increases their bargaining ability.

Fourth, there is high supply elasticity. Competitive providers have deployed more than 800 route miles of optical fiber in the Phoenix MSA. These extensive fiber backbone networks could handle all of U S WEST's end user and transport traffic at less than eight percent capacity. The only real constraint on competitive providers expanding service to U S WEST's customers is the need to build facilities to connect these sites to their existing fiber backbone networks. In most cases, this is not an issue at all. Approximately 65 percent of U S WEST's current high capacity demand (DS1 equivalents) in the Phoenix area is located within 100 feet of existing competitive provider fiber networks, which means that it is essentially located "on-network." Thus, competitive providers could absorb a majority of U S WEST's high capacity demand almost immediately, incurring only minimal costs.

Moreover, as the attached report prepared by POWER Engineers, Inc. demonstrates, competitive providers would not incur significant costs to extend their fiber networks to absorb the vast majority of U S WEST's current high capacity demand. Specifically, competitive providers in Phoenix can serve all of U S WEST's high capacity customer locations within 1,000 feet of their existing fiber networks (representing 86 percent of U S WEST's high capacity demand) if they invest $45 million, and all of existing U S WEST's high capacity customer locations within 9,000 feet of their existing fiber networks (representing approximately 95 percent of U S WEST's high capacity demand) if they invest approximately $127 million. Given that U S WEST's share of the Phoenix area market for high capacity services is worth approximately $50 million on an annual basis and the fact that the market has been growing steadily at about 13 percent annually, it is economically rational to assume that competitive fiber networks would be able to absorb most, if not all, of U S WEST's existing customers within a relatively short period of time.

Fifth, U S WEST does not enjoy an advantage in terms of its costs, structure, size and resources. To the contrary, the combined AT&T/TCG and MCI/MFS WorldCom companies enjoy a significant advantage in terms of scale economies and access to capital, not to mention the advantage of being able to provide interLATA services. The presence of competitive activity in the market while prices are dropping steadily is a strong indication that U S WEST does not have an insurmountable cost advantage in the market.

In light of U S WEST's lack of market power, Professors Kahn and Tardiff conclude that competition, without dominant carrier regulation, is sufficient to constrain U S WEST's ability to impose anti-competitive prices and other terms and conditions of service. In fact, Kahn and Tardiff conclude that continuing dominant carrier regulation of U S WEST's high capacity services in this highly competitive environment would be "anti-competitive and injurious to consumers."

2. U S WEST's Petition Satisfies The Section 10 Criteria For Forbearance

Section 10 requires the FCC to forbear from applying any regulation or provision of the Communications Act if the three statutory criteria are met. The statutory imperative created by Section 10 reflects Congress's reasoned judgment that competition, not government regulation, should guide companies' behavior in a competitive telecommunications market. U S WEST's petition satisfies the Section 10 criteria for forbearance and is supported by substantial market evidence in accordance with the recent statements of Chairman Kennard.

First, dominant carrier regulation of U S WEST's high capacity services in the Phoenix area is not necessary to ensure that rates and practices are just, reasonable, and not unreasonably discriminatory. U S WEST does not have the power to control prices in this market nor the ability to act in a discriminatory manner.

Second, because U S WEST cannot control prices or act in a discriminatory manner, dominant carrier regulation is not necessary to protect consumers.

Third, continuing to subject U S WEST's high capacity services in the Phoenix area to dominant carrier regulation deprives customers of the benefits of true competition by imposing unnecessary costs on U S WEST and hampering its ability to quickly and effectively respond to competitive initiatives. Further, asymmetrical regulation of U S WEST's high capacity services results in competitive distortions (e.g., "umbrella" pricing) that do not serve the public interest.

3. U S WEST Is Not Requesting That Its High Capacity Services Be Deregulated

U S WEST is not requesting that its high capacity services be deregulated - it is requesting only that the FCC exercise its Section 10 forbearance authority and regulate U S WEST as a non-dominant carrier in the Phoenix area market for high capacity services. As a non-dominant provider, U S WEST should be subject to permissive detariffing, which would allow, but not require, the filing of tariffs on one-day's notice with a presumption of lawfulness and without any cost support. The FCC also should free U S WEST's high capacity services from price cap and rate of return regulation, which are appropriate only for dominant carrier services. Moreover, the FCC should forbear from applying Section 69.3(e)(7) of its rules so that U S WEST can charge deaveraged rates within the Phoenix MSA. The effect of granting U S WEST's petition would be to place U S WEST on equal footing with all other competitors in the Phoenix area market for high capacity services.

Competitors at a Glance

The following matrices provide summary information for high capacity facilities-based competitors in the Phoenix MSA. For additional information please refer to the appendix attached.

	WorldCom	TCG	MCI
Overall Strategy	One-stop provider for communications services, including local exchange, HICAP, data, internet, long-distance.	Leading provider of communications solutions to businesses. Service packages include local, data, long-distance, HICAP.	One-stop, single billing for businesses. Services include local, long-distance, HICAP, data.
Approximate Route Miles	75	>300	20-40
On-net Buildings	>50	>150	25-35
Central Office Switching	Nortel DMS 500	Lucent 5ESS	Nortel DMS 500
Network Establishment	2Q95	2Q94	1996
Business Target Markets	Traditional focus on the middle market. Seeks national accounts, solicits to other tenants in on-net buildings. Focus on existing WorldCom, UUNET customers.	Traditional focus on high-end users, now moving "down-market." Most TCG customers have enormous communications needs.	Traditional focus on large businesses. Relies heavily on existing L.D. customer base. Reputation for outstanding customer service.
Residential Target Markets	Not actively targeting	Not actively targeting	Not actively targeting
Geographic Areas	Phoenix's central business district, Camelback/Lincoln areas, Tempe, Scottsdale, and the Sky Harbor Airport	Area wide. Central Phoenix, Camelback, Scottsdale, Tempe, Mesa, Chandler, Glendale, Paradise Valley, Phoenix Sky Harbor Intl. Airport, Tolleson	Fiber is located in Phoenix's central business district (although MCI provides services in Mesa, Scottsdale, and Tempe via resale and use of U S WEST facilities)
Competitive Alliances	Pending merger with MCI to form MCI WorldCom	Pending merger with AT&T	Pending merger with WorldCom to form MCI WorldCom

(Continued on next page)

COMPETITORS AT A GLANCE

	ELI	GST
Overall Strategy	Provider of diversified communications services, including local, L.D., HICAP, and data services	Provider of integrated communications services – DS-0 through OC-N, data services, local exchange, ISDN
Approximate Route Miles	400	11 miles in downtown Phoenix with an additional 18 miles of right-of-way and conduit available for expansion. 300 Route miles of fiber in the state of Arizona
On-net Buildings	30-45	15-25
Central Office Switching	Nortel DMS 500	Nortel DMS 500
Network Establishment	1995	1996
Business Target Markets	Middle market and high-end users, ISPs.	All business customers, large and small.
Residential Target Markets	Not currently targeting	Not currently targeting
Geographic Areas	Throughout the metropolitan area. Central Phoenix, Tempe, Mesa, Chandler, Glendale, Paradise Valley, Tolleson, Gilbert.	Downtown Phoenix and Southern Arizona
Competitive Alliances	Partnership with Salt River Project (local utility provider) in Phoenix	Formed Phoenix Fiber Access with ICG in 1995. Purchased ICG half in 1997.